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Department of the Treasury

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Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:B04

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Date:

May 05, 2010

Legend:

Distributing =

Controlled =

Newco =

Entity A =

Entity B =

Entity C =

Business A =

Business B =

a =

b =

c =

Dear :

This letter responds to your November 20, 2009 request for rulings regarding certain federal income tax consequences of a proposed transaction (the "Proposed Transaction"). The information submitted in that request and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the Proposed Transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of the distributing or controlled corporation or both (see § 355(a)(1)(B) of the Internal Revenue Code (the "Code") and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing or controlled corporation (§ 355(e)(2)(A)(ii) and § 1.355- 7).

Summary of Facts

Distributing is a closely held subchapter S corporation that is engaged in Business A. Distributing has one class of voting common stock outstanding that is owned in varying percentages by a shareholders (the "Distributing Shareholders"). Distributing wholly owns the stock of Controlled, a qualified subchapter S subsidiary ("QSub") that is engaged in Business B. Financial information submitted by Distributing indicates that Business A and Business B have each had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

Entity A, Entity B and Entity C are subchapter S corporations that are engaged in Business B. Shareholders of Distributing own between b percent and c percent of the voting stock of each of Entity A, Entity B and Entity C.

Proposed Transaction

For what is represented to be a valid business purpose, Distributing has proposed the following transaction to separate Business A from Business B (the "Proposed Transaction"):

- (i) Distributing will distribute all of the stock of Controlled to the Distributing Shareholders (the "Distribution").
- (ii) Pursuant to § 1.1361-5(b)(i), the Distribution will result in a termination of Controlled's QSub election with Controlled being treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination, from Distributing in exchange for stock of Controlled (the "Contribution"). Distributing will be deemed to have distributed the stock of Controlled to the Distributing Shareholders in the Distribution.
- (iii) Controlled shareholders and the shareholders of each of Entity A, Entity B, and Entity C will form Newco. The shareholders of Controlled will each transfer to Newco, all of their shares in Controlled in exchange for Newco common stock. The shareholders of Entity A, Entity B, and Entity C will each transfer to Newco all of their shares in Entity A, Entity B, and Entity C in exchange for Newco common stock.
- (iv) Newco will elect to be an S corporation pursuant to § 1362(a) and will also elect to treat Controlled, Entity A, Entity B, and Entity C as qualified subchapter S subsidiaries pursuant to § 1361(b)(3)(B). Controlled shareholders will own more than 50-percent of the Newco stock.

Representations

The taxpayer has made the following representations regarding the Contribution and Distribution:

- (a) No part of the consideration to be distributed by Distributing will be received by any shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of Distributing's Business A and Business B represents the present operations of each business, and

regarding each business, there have been no substantial operational changes since the date of the last financial statements submitted.

(c) Neither Business A conducted by Distributing nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the distribution, Distributing will have been the principal owner of the goodwill and significant assets of Business A and will continue to be the principal owner following the distribution.

(d) Neither Business B that will be deemed contributed to Controlled nor control of an entity conducting this business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Prior to the Contribution, Distributing will have been the principal owner of the goodwill and significant assets of Business B. Following the Contribution, Controlled will be the principal owner of the goodwill and significant assets of Business B.

(e) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(f) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50-percent or more of the total combined voting power of all classes of Controlled stock entitled to vote or 50 percent or more of the total value of shares of all classes of Controlled stock that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

(g) Following the Distribution, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

(h) The Distribution is being carried out for the following business purposes: to create synergy among the Business B entities, to allow Controlled to seek new capital and to insulate Business A from the risk associated with Business B. The Distribution is motivated, in whole or substantial part, by these corporate business purposes.

- (i) The Distribution is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (j) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of such corporation).
- (k) The total fair market value of the assets deemed transferred by Distributing to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange, and (iii) the amount of cash and the fair market value of any other property (other than stock and securities permitted to be received under § 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (l) The total adjusted basis of the assets deemed to be transferred to Controlled by Distributing each will equal or exceed the sum of the liabilities deemed to be assumed (as determined under § 357(d)) by Controlled and the liabilities deemed assumed (as determined under § 357(d)) by Controlled in the Proposed Transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets deemed to be transferred.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or after the Distribution, other than intercompany loans or obligations that have arisen, or will arise, between the parties in the ordinary course of business.
- (n) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (o) Distributing is a subchapter S corporation (within the meaning of § 1361(a)). Controlled is a qualified subchapter S subsidiary (within the meaning of § 1361(b)(3)(B)). There is no plan or intention to revoke or otherwise terminate the S corporation election of Distributing.
- (p) Controlled will elect to be a subchapter S corporation pursuant to § 1362(a) on the first available date after the Distribution.
- (q) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).

(r) No property deemed transferred between Distributing and Controlled has, or will, claim investment credit under § 46.

Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows on the Contribution and Distribution:

- (1) The Contribution, followed by the Distribution will qualify as a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" under § 368(b).
- (2) Distributing will recognize no gain or loss on the Contribution (§ 357(a) and § 361(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (§ 1032(a)).
- (4) The basis that Controlled has in each asset received from Distributing in the Contribution will equal the basis of that asset in the hands of Distributing immediately before its transfer (§ 362(b)).
- (5) The holding period of each asset received by Controlled in the Contribution will include the period Distributing held that asset (§ 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the Distribution (§ 361(c)(1)).
- (7) No gain or loss will be recognized by (and no amount will be included in the income of) the Distributing Shareholders upon the receipt of Controlled stock (§ 355(a)(1)).
- (8) The aggregate basis of the Distributing stock and the Controlled stock in the hands of the Distributing Shareholders immediately after the Distribution will equal the Distributing Shareholder's aggregate basis in the Distributing stock held immediately before the Distribution. Such aggregate basis will be allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b) and (c)).
- (9) The holding period of the Controlled stock received by the Distributing Shareholders will include the holding period of the Distributing stock on which the Distribution is made, provided such stock is held as a capital asset on the date of the Distribution (§ 1223(1)).
- (10) A proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with § 312(h) and § 1.312-10(a).

(11) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under § 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under § 1361, Controlled will be eligible to make a subchapter S election under § 1362(a) for its first taxable year, provided such election is made effective immediately following the termination of the original QSub election.

(12) The accumulated adjustments account of Distributing will be allocated between Distributing and Controlled in a manner similar to the manner in which earnings and profits of Distributing will be allocated under § 312(h) in accordance with Treas. Reg. § 1.1368-2(d)(3).

Caveats

No opinion is expressed about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding: (i) whether the Distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see § 355(a)(1)(B) and § 1.355-2(d)); (iii) whether the Distribution and an acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii); (iv) whether Distributing is a valid S Corporation prior to the Distribution; (v) whether Controlled will be a valid S corporation after the Distribution; (vi) whether Entity A, Entity B and Entity C are valid S corporations prior to the Proposed Transaction; (vii) whether Controlled, Entity A, Entity B and Entity C are valid QSubs after the Proposed Transaction; and (viii) the federal income tax consequences of steps (iii) and (iv).

Procedural Statements

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Each taxpayer involved in the Proposed Transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the Proposed Transaction is completed. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their returns that provides the date and control number of the letter ruling.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel (Corporate)